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Supreme Court, U.S.
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No. _____

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

AMERICAN UNDERWRITERS GROUP, INC.,

Petitioner,

v.

HARRY E. EAKIN, as the Insurance Commissioner of the Department of Insurance of the State of Indiana,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE INDIANA COURT OF APPEALS SECOND DISTRICT

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QUESTION PRESENTED

Does the construction of a state insurance insolvency statute such as Indiana Code 27-9 resulting in the application of the statute to attorneys-in-fact or agents for subscribers or policyholders of a reciprocal insurer impinge upon the Bankruptcy Code and thus render the state statute unenforceable under the Constitution?

In other words, does the Bankruptcy Code under the Constitution pre-empt the application of a state insurance insolvency statute such as Indiana Code 27-9 to attorneys-in-fact or agents for subscribers or policyholders of a reciprocal insurer?

LIST OF PARTIES

Petitioner American Underwriters Group, Inc., has no parent companies or subsidiaries to be listed pursuant to Rule 29.1.

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The petitioner American Underwriters Group, Inc., ("AUG") respectfully prays that a writ of certiorari issue to review the judgment of the Indiana Court of Appeals, Second District, which reversed the judgment of the trial court in this case.

OPINIONS BELOW

The opinion of the Indiana Court of Appeals is reported at 552 N.E.2d 50 and is reprinted in the Appendix separately filed herewith at A-1.

JURISDICTION

The judgment of the Indiana Court of Appeals was entered on April 10, 1990. The Court of Appeals denied AUG's timely petition for rehearing on June 5, 1990. The Indiana Supreme Court denied AUG's timely petition to transfer this case to that court for review on November 27, 1990. The jurisdiction of this Court is

invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The Constitution provides that "Congress shall have Power . . . To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States" (art. I, § 8, cl. 4) and that "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land" (art. VI, cl. 2).

Section 109 of the Bankruptcy Code, 11 U.S.C. § 109, provides in part:

> (a) . . . only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.
>
> (b) A person may be a debtor under chapter 7 [and chapter 11] of this title only if such person is not (1) a railroad, (2) a domestic insurance company, bank, . . .; or (3) a foreign insurance company, bank, . . . engaged in such business in the United States.

Pertinent provisions of the Indiana Code ("IC") regarding the "Indiana Insurance Law" (IC 27-1), interinsurance (IC 27-6-6), and the rehabilitation and liquidation of an "insurer" (IC 27-9) are set forth in the Appendix.

STATEMENT OF THE CASE

The following facts in the record below are undisputed.

American Interinsurance Exchange ("AIE") is an unincorporated association acting as a reciprocal insurer organized under the interinsurance provisions of IC 27-6-6. Pursuant to those provisions, "subscribers" or policyholders of AIE are authorized to exchange reciprocal or interinsurance contracts with each other providing indemnity among themselves. Such contracts are executed by an "attorney" who is authorized by and acts as an agent for the subscribers. IC

27-6-6-1 and 2 (A-22).

AUG is a regular corporation organized under the Indiana Business Corporation Law and not under the interinsurance provisions. AUG's articles of incorporation empower AUG to act as attorney-in-fact for a reciprocal insurer and further to engage generally in any lawful business. AUG's business activities have included owning and operating other corporations as wholly-owned subsidiaries.

An "Inter-Insurance Certificate of Authority" was issued by the Indiana Department of Insurance ("Department") which authorized AUG as "attorney-in-fact" for the subscribers of AIE "to issue and exchange contracts of inter-insurance under the name and designation of American Interinsurance Exchange." The relationship between AUG

as agent and AIE as principal was established by a "Power of Attorney and Subscribers' Agreement at American Interinsurance Exchange" which was signed by every AIE subscriber and which appointed AUG as agent to exchange insurance contracts in the name of AIE among the subscribers.

Policies of insurance were written in the name of "American Interinsurance Exchange" and not in the name of AUG. All insurance transactions in exchanging AIE contracts were performed by AUG as the appointed agent and attorney-in-fact for the subscribers of AIE. When AUG acted as an agent, AUG executed and signed documents "American Underwriters Group, Inc., as Attorney-in-Fact for the Subscribers at American Interinsurance Exchange." When AUG acted in its own capacity in conducting its own business,

AUG executed and signed documents in its own name.

AUG and AIE maintained separate bank accounts. Insurance premiums on AIE policies were collected by AIE employees and deposited in AIE's bank accounts. Insurance claims arising from AIE insurance contracts were processed by AIE employees and paid from AIE's bank accounts. Expenses of AIE insurance operations were paid from AIE's bank accounts. Separate payroll accounts were maintained for AIE employees who were paid from AIE's bank accounts.

Separate books and records and separate financial statements were prepared for AUG and for AIE. Independent accountants separately audited and reported on those accounts and statements. Insurance claims arising from AIE insurance contracts were

recorded as a liability designated "Loss reserves" in AIE's financial statements. No loss reserves for insurance claims were recorded as a liability in AUG's financial statements.

AUG and AIE filed separate federal and state tax returns with their own identification numbers and never filed consolidated tax returns.

Every three years the Department conducted an examination of AIE. The Department's 1984 examination report of AIE stated that it was an examination of the financial condition and affairs of "American Interinsurance Exchange . . . an Indiana Fire and Casualty, reciprocal insurer." The report stated that AUG acted as the Attorney-in-Fact for the subscribers at AIE and, as AIE's agent, managed AIE's affairs. It further stated "the Exchange writes insurance." The

Department has never found that any assets, accounts or liabilities of AIE were commingled with those of AUG.

As a corporation regulated by the Securities and Exchange Commission, AUG files a Form 10-K on an annual basis. Its 1987 10-K described the legal relationship between AUG and AIE as follows:

> The company has no equity interest in the assets, unassigned surplus and net income of the Exchange. In addition, no liabilities of the Exchange are liabilities of the Company, and no liabilities of the Exchange are transferable to the Company.

An Order of Rehabilitation of AIE under IC 27-9 was entered on April 6, 1988. AUG, acting as Attorney-in-Fact for AIE, consented to the entry of the Order. The President of AUG testified that AUG then ceased acting as the appointed agent for AIE and the agency

relationship was terminated.

On May 4, 1988, the Commissioner of the Department filed a Petition for Rehabilitation of AUG pursuant to IC 27-9. The trial court entered a judgment denying the petition (A-12) which was reversed by the Indiana Court of Appeals.

In construing IC 27-9, the Court of Appeals concluded as a matter of law that AUG is an "insurer" under IC 27-9 on the basis of the certificate of authority issued to AUG. It thus observed that the certificate authorizes AUG "to make contracts of insurance" pursuant to IC 27-6-6-9 "albeit in the name of AIE," and it then jumped to the conclusion that AUG is an insurer "because it is licensed to do insurance business." (A-9). The Court ignored all authorities previously cited by AUG and based its judgment on points never argued by the Commissioner.

How The Federal Question Was Presented

AUG first raised the federal question sought to be reviewed in its petition for rehearing filed with the Court of Appeals on April 30, 1990 (A-123). AUG again raised the federal question in its petition to transfer filed with the Indiana Supreme Court on June 22, 1990 (A-126). In each instance, AUG filed a brief on the merits as well as the timeliness of the question. In each instance, AUG's petition was denied without opinion (A-15, 16).

The Commissioner has argued that AUG raised its federal question too late. The constitutional question is whether the Bankruptcy Code pre-empts the application of IC 27-9 to AUG. That question goes to the state's actual adjudicatory or regulatory power as opposed to the state's substantive laws.

It is the same type of question considered by this Court in International Longshoremen's Ass'n v. Davis, 476 U.S. 380 (1986), which recognized that the pre-emptive effect of the NLRA "is in the nature of a challenge to a court's power to adjudicate that may be raised at any time." Id. at 382. Davis held that "noncompliance with state procedural rules governing affirmative defenses did not present an independent and adequate state ground" to preclude review of the pre-emption issue which the state court had refused to decide. Id. at 399.

Davis is strikingly similar to this case. The pre-emption issue there turned on the status of Davis under the NLRA. If he was a "supervisor," there was no pre-emption; if he was an "employee," there was. Id. at 394-395. In this case, the pre-emption issue turns on the

question as to whether AUG is a "person" eligible for relief under the Bankruptcy Code or whether AUG is an "insurance company" and thus not eligible under the Bankruptcy Code. In explaining its reasoning for reviewing the pre-emption issue, Davis furthermore cited a bankruptcy case where this Court based its holding on

> Congress' exclusive right to regulate bankruptcy, which gave it the power to vest jurisdiction over bankruptcy proceedings exclusively in one forum and to withdraw that jurisdiction from all other forums, and Congress' statutory exercise of that right.

Id. at 393, n.11.

In a similar vein, AUG has previously cited In re Mader's Store for Men, Inc., 77 Wis.2d 578, 254 N.W.2d 171 (1977), for the proposition that this constitutional argument raises a question of subject matter jurisdiction which cannot be waived. As recognized in Mader's, this

Court has characterized proceedings under state insolvency legislation which is suspended by reason of the enactment of the Bankruptcy Code as being "utterly null and void" and "subject to collateral attack." Id. at 254 N.W.2d 176 & n.1.

AUG also has cited Fort Wayne Patrolman's Benevolent Ass'n v. City of Fort Wayne, 408 N.E.2d 1295, 1300 (Ind. Ct. App. 1980), which held that procedural rules are inapposite where a statute has been declared unconstitutional while a case has not yet completed the appellate process. In raising the federal question, AUG relied in part upon In re Family Health Services, Inc., 104 B.R. 268 (Bankr. C.D. Cal. 1989), ("Family Health Services I"), which denied a motion to dismiss a bankruptcy petition filed by a health maintenance organization because the HMO

was not excluded from the Bankruptcy Code as an "insurance company." That case involved the Commissioner as a party and the provisions of IC 27-9. While it did not decide a constitutional issue, it did consider Indiana law and thoroughly analyzed the predicate of AUG's argument which is that AUG is not an "insurance company." It was not decided, however, until July 25, 1989, which was after this case had been fully briefed in the Court of Appeals. Since this case remained justiciable, this argument should not have been ignored.

Finally, where the decision of the state court is a "surprise" and could not have been reasonably anticipated, raising the federal question for the first time in a petition for rehearing is timely even though the state court says nothing in denying the petition. R. Stern, E.

Gressman, & S. Shapiro, Supreme Court Practice 156-157 (6th ed. 1986). Throughout this case, AUG has cited Underwriters' Exchange v. Indianapolis St. Ry., 204 Ind. 676, 185 N.E. 504, 506-507 (1933), which specifically held that an attorney-in-fact acting for a reciprocal insurer is not an insurer itself. The power of attorney in that case is similar to the power signed by every subscriber of AIE, and the method of doing insurance business in that case is identical to the method in which AIE as an unincorporated association transacted business through AUG as its attorney. That case further considered the very same provisions now appearing in IC 27-6-6-9 (A-32) regarding the certificate of authority which the Court of Appeals considered in this case. The Court of Appeals, however, inexplicably

ignored this precedent.

The Court of Appeals furthermore based its decision on points never argued by the Commissioner at any time. Most importantly, the Commissioner never argued that AUG was licensed to do business as an "insurer" itself. Instead, he has argued that AUG and AIE were inextricably intertwined in a single insurance enterprise. Throughout this case, AUG has also cited Indiana Dept. of Revenue v. American Underwriters, Inc., 429 N.E.2d 306, 311-312 (Ind. Ct. App. 1981), rehearing denied, 431 N.E.2d 528 (1982), which analyzed the relationship between AUG and AIE and ultimately concluded that AUG is a separate and distinct entity for tax purposes. The Court again inexplicably ignored this precedent as well as all other precedents cited by AUG. The Court in fact cited no

precedent whatsoever in its opinion.

For all of the foregoing reasons, AUG's federal question was timely and properly raised.

REASONS FOR GRANTING THE WRIT

I.

By construing IC 27-9 to apply to AUG, the decision below results in a conflict with the Bankruptcy Code and decisions of this Court holding that the Bankruptcy Code pre-empts conflicting state insolvency laws.

The decision below extends the power and jurisdiction of Indiana to a subject matter which this Court has held to be exclusively within the domain of Congress since it exercised its power under the Constitution to establish a national bankruptcy law. Section 109 of the Bankruptcy Code has been drafted to make relief under the Code widely available. Exclusions are limited and carefully delineated. 2 Collier on Bankruptcy ¶

109.01 (15th ed. 1979). IC 27-9 is "tantamount to bankruptcy" and cannot constitutionally be applied to AUG since AUG is not an "insurance company" within the scope of the provisions excluding persons from the Bankruptcy Code.

The Bankruptcy Code pre-empts conflicting state law.

Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122 (1819), was the seminal case enunciating the pre-emptive effect of federal bankruptcy legislation. Sturges was decided at a time when there was no federal bankruptcy law. The question certified in that case was whether any state has authority to pass a bankrupt law since the adoption of the Constitution or whether such power is exclusively vested in Congress. The Court noted that states had the power to pass bankrupt laws before the

Constitution and that the question depended on the "peculiar terms" of the grant of power to Congress. Under those terms, "Congress is not authorized merely to pass laws, the operation of which shall be uniform, but to establish uniform laws on the subject throughout the United States." Envisioning exclusions such as the very exclusion of insurance companies involved in this case, the Court observed that "Congress may purposely omit to provide for many cases to which their power extends." Id. at 193, 195. Chief Justice Marshall reasoned:

> It is not the mere existence of the power, but its exercise, which is incompatible with the exercise of the same power by the states. It is not the right to establish these uniform laws, but their actual establishment, which is inconsistent with the partial acts of the states. . . . If the right of the states to pass a bankrupt law is not taken away by the mere grant of that power to Congress,

> it cannot be extinguished; it can only be suspended, by the enactment of a general bankrupt law.

Id. at 196. Sturges held that

> a state has authority to pass a bankrupt law . . . provided there be no act of Congress in force to establish a uniform system of bankruptcy, conflicting with such law.

Id. at 208. Since there was no federal law in force then, it was unnecessary to decide whether the state statute in that case was or was not a "bankrupt law."

International Shoe Co. v. Pinkus, 278 U.S. 261 (1929), considered a state statute after Congress passed the Bankruptcy Act. A plaintiff had obtained a judgment against Pinkus who then commenced a suit asking to be adjudged insolvent and for the appointment of a receiver to take and distribute his property as directed by the state statute. The state court complied. The plaintiff then brought an action alleging

that the state statute had been suspended by the passage of the Bankruptcy Act. Citing Sturges and a string of cases, the Court first said:

> A state is without power to make or enforce any law governing bankruptcies that . . . conflicts with the national bankruptcy laws.

Id. at 263-264. The Court then recognized Congress' intent to exclude state action on the subject:

> In respect of bankruptcies the intention of Congress is plain. The national purpose to establish uniformity necessarily excludes state regulation. It is apparent, without comparison in detail of the provisions of the Bankruptcy Act with those of the Arkansas statute, that intolerable inconsistencies and confusion would result if that insolvency law be given effect while the national act is in force. Congress did not intend to give insolvent debtors seeking discharge, or their creditors seeking to collect claims, [a] choice between the relief provided by the Bankruptcy Act and that specified in state insolvency laws. States may not pass or enforce laws to interfere with or complement the Bankruptcy Act, or to provide additional or auxiliary regulations.

Id. at 265 (emphasis added).

Pinkus held that the state statute was an insolvency law. It was so designated in its title, and the state courts treated it as such. It provided for surrender by the insolvent of all non-exempt property to be liquidated by a trustee for the payment of debts under the direction of the court. It classified creditors, prescribed the order of payment of claims, and gave preferences to those fully discharging the debtor in consideration of pro-rata distribution. According to the Court, the state statute operated within the field occupied by the Bankruptcy Act, "and therefore such provisions must be held to have been superseded." Id. at 264, 266.

Again citing Sturges and a string of cases including Pinkus, the Court in

Straton v. New, 283 U.S. 318, 327 (1931), recognized as a

> settled rule that state insolvency laws which are tantamount to bankruptcy because they provide for an administration of the debtor's assets and a winding up of his affairs similar to that provided by the national act are suspended while the latter remains in force, and proceedings under them are utterly null and void whether commenced within four months of the filing of a petition in bankruptcy or before.

Straton involved a bankruptcy order which enjoined a judicial sale of real estate in a creditor's suit filed in a state court to enforce a judgment lien. The bankruptcy trustee contended that the creditor's suit was a general disposition of the debtor's property and a winding-up proceeding pursuant to state law and was therefore superseded. After stating the above rule, the Court rejected the trustee's contention that the creditor's action was an insolvency proceeding

because the statute providing for such suits said nothing about a distribution of assets among general creditors, and it contained no provision that lien claims which could not be paid due to insufficient proceeds of the sale would be wiped out. Rather, it merely regulated proceedings in equity under an ordinary writ in execution. Id. at 327-329.

IC 27-9 is "tantamount to bankruptcy."

IC 27-9 furnishes an exclusive and comprehensive scheme for the administration of an insurer's assets and the winding up of its affairs. Delinquency proceedings under IC 27-9 include:

> Any proceeding instituted against an insurer for the purpose of liquidating, rehabilitating, reorganizing, or conserving that insurer.

IC 27-9-1-2(d)(1) (A-43). IC 27-9-1-3

(A-45) provides that no person except the Commissioner may commence a delinquency proceeding, that no such action may be entertained except in accordance with IC 27-9, and that no such action may be brought except in the Marion Circuit Court.

IC 27-9-3-2 (A-52) requires that any order of rehabilitation shall appoint the Commissioner as rehabilitator and shall vest title to all assets of the insurer in the Commissioner. IC 27-9-3-3 (A-54) gives the Commissioner plenary power to deal with the insurer's business and property and, subject to court approval, to develop a reorganization plan. IC 27-9-3-7 (A-58) likewise requires that any order of liquidation shall appoint the Commissioner as liquidator and shall vest title to all assets of the insurer in the Commissioner. IC 27-9-3-9 (A-61)

provides for the dissolution of the insurer and grants the Commissioner plenary power to deal with the insurer's business and property, including the power to affirm or disavow contracts. IC 27-9-3-10 and 11 (A-69) provide for the giving of notice and the requirement to file claims. If proper notice is given, the distribution of assets is conclusive as to all claimants. IC 27-9-3-12 (A-75) bars the filing or maintenance of any suits against the insurer or Commissioner after the liquidation order is issued. IC 27-9-3-14--27 (A-79) establish the power of the Commissioner to avoid preferences and fraudulent conveyances. IC 27-9-3-34--39 (A-102) and 41 (A-120) establish procedures for the filing, review, allowance, denial, and adjudication of claims. IC 27-9-3-40 (A-115) establishes a classification and

priority of distribution of all claims.

IC 27-9 thus provides for the involuntary surrender and marshalling of all assets of the debtor for reorganization or liquidation, the assessment of the validity of all creditors' claims, and a classification and priority of distribution for all claims. For Indiana insurance companies, IC 27-9 is the functional equivalent of the Bankruptcy Code, and it is not merely a receivership or assignment for the benefit of creditors. The Commissioner implicitly acknowledged this functional equivalency when he unsuccessfully argued that health maintenance organization insolvencies were subject to IC 27-9 rather than the Bankruptcy Code. Family Health Services I

Indeed, the very existence of such state insurance insolvency laws is the

reason Congress chose not to include insurance companies within the Bankruptcy Code:

> Insurance companies are among those entities precluded from being debtors under the Code because Congress has determined not to interfere with the state's comprehensive liquidation scheme.

In re Cash Currency Exchange, Inc., 37 B.R. 617 (N.D. Ill. 1984), aff'd, 762 F.2d 542, 556 (7th Cir. 1985), cert. denied, 474 U.S. 904 (1985) ("Cash Currency").

It cannot seriously be maintained that IC 27-9 does not conflict with the Bankruptcy Code if it is to be applied to a debtor who may be eligible for bankruptcy relief. By virtue of IC 27-9-1-3 (A-45), the Commissioner is the only person who may commence an insolvency proceeding against an insurer, and the Marion Circuit Court is the only

court which may entertain any such proceeding. The effect of the Indiana scheme is to deny creditors of entities covered by IC 27-9 and the entity itself the right to avail themselves of the benefits of the Bankruptcy Code. That effect is fatal because "a corporation may not be precluded by state law from availing itself of federal bankruptcy law." Cash Currency, 762 F.2d at 552.

The main purpose of the federal bankruptcy law has been the equal treatment of all creditors and equal distribution of the debtor's property. Buchanan v. Smith, 83 U.S. 277, 301 (1873); Mayer v. Hellman, 91 U.S. 496, 501 (1876); Boese v. King, 108 U.S. 379, 386 (1883). It should be noted that the 1978 Bankruptcy Act eliminated the provision for discharge of debts of corporations and other nonindividuals,

and discharge is thus not an essential element or purpose of the federal bankruptcy law. In re Quanta Resources Corp., 739 F.2d 912, 915 n.7 (3d Cir. 1984), aff'd, 474 U.S. 494 (1986).

IC 27-9 clearly conflicts with the purpose and intent of the federal bankruptcy scheme. In considering the scheme of IC 27-9, Family Health Services I found three areas of conflict: (1) the Bankruptcy Code provides unsecured creditors with significant powers and protection not afforded under IC 27-9; (2) IC 27-9 grants a preferential priority for payment of claims which "is anathema to the basic tenet of federal bankruptcy law"; (3) the Bankruptcy Code, unlike IC 27-9, provides a nationwide, uniform and pervasive system for the reorganization of financially distressed companies. 104 B.R. at 277-278. The

conflict between IC 27-9 and the Bankruptcy Code is so fundamental and pervasive that IC 27-9 cannot be applied to any entity eligible to be a debtor under the Bankruptcy Code.

AUG is not an "insurance company."

If an attorney-in-fact such as AUG is not an "insurance company" as that term is used in Section 109(b) of the Bankruptcy Code, an attempt to subject such entities to a state insolvency scheme such as IC 27-9 runs afoul of the Supremacy Clause. The critical question thus is: what is meant by "insurance company" as that term is used in the list of excluded entities in Section 109(b)?

The Bankruptcy Code does not define any of the entities enumerated in Section 109(b). Three different tests identified infra have evolved for determining those entities. All three tests lead to the

same conclusion: an attorney-in-fact, such as AUG, is not an insurance company for purposes of Section 109(b) and, hence, is not excluded from the Bankruptcy Code.

The Independent Classification Test

In applying this test, a court is guided by its own construction of the Bankruptcy Code. Family Health Services I, 104 B.R. at 272; Cash Currency, 37 B.R. at 621. This test ultimately seeks to determine whether the entity at issue performs the essential functions of one of the entities enumerated in Section 109(b). For example, courts seeking to determine whether various entities are "banks" have examined the powers of such entities to see if they are authorized to perform the "essential function" of a bank -- to accept deposits. See Cash Currency, 37 B.R. at 626; In re Republic

Trust & Savings Co., 59 B.R. 606, 613 (Bankr. N.D. Okla. 1986); In re Southern Industrial Banking Corp., 59 B.R. 978, 985 (E.D. Tenn. 1986).

In the matter of insurance, courts have held that the central, indispensable element of an insurance company is the underwriting or spreading of a risk. Family Health Services I, 104 B.R. at 275; In re Family Health Services, Inc., 104 B.R. 279, 284 (Bankr. C.D. Cal. 1989) ("Family Health Services II"). In so holding, those cases relied on Group Life & Health Ins. Co. v. Royal Drug Co., 440 U.S. 205 (1979), cert. denied, 469 U.S. 1160 (1985), which construed the phrase "business of insurance" in the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015. Royal Drug stated that the indispensable element of insurance is the underwriting and spreading of a

policyholder's risk, and a second, critical aspect of insurance is the existence of a contract between the insured and the insurer. Id. at 215.

The Royal Drug test demonstrates conclusively that under Indiana law an attorney-in-fact, such as AUG, does not engage in the business of underwriting risks and it is not a party to the insurance contract. Underwriters' Exchange, supra at 185 N.E. 506-507, recognized the function of an attorney-in-fact:

> . . . the fact must not be overlooked that reciprocal or interinsurance contracts are distinguishable from all other forms of insurance, in that every insured is an interinsurer and every insurer is insured. [The attorney-in-fact] is neither an insurer or insured. It has suffered no loss. While it was the medium through which the loss was paid, such payment tended to deplete only the account of the subscribers.

(Emphasis added.) Under Indiana law an

attorney-in-fact, such as AUG, neither underwrites the risk insured against ("It has suffered no loss") nor is a party to the insurance contract (it "is neither an insurer or insured"). Thus, under this test, AUG does not possess the essential elements of an insurance company, and it is not, therefore, excluded from the Bankruptcy Code.

The State Classification Test

Under this test, courts look primarily to state law to determine the nature of an entity for purposes of Section 109(b). Recent cases, however, make clear that the issue is not controlled by state law:

> The "state classification test" was somewhat illusory, for no State scheme could override Congress' own intention as to who should be eligible for bankruptcy relief . . .

In re Republic Trust & Savings Co., supra at 59 B.R. 611. Family Health Services

II made the same point at 104 B.R. 283:

> Congress dictates which entities are precluded from seeking bankruptcy relief and Congress has not delegated that authority to the states. Therefore, a state can never transform an eligible entity . . . into an insurance company, which is ineligible under Section 109.

This test thus looks beyond any simple labels applied by state law and instead considers a variety of factors. An excellent example of the current formulation of this test is described in Family Health Services I at 104 B.R. 273:

> Under the state classification test the court examines the law of the state of incorporation to determine the character of an entity for section 109 purposes. The analysis begins with whether the state law classifies the entity as one specifically excluded from being a debtor under section 109(b)(2). Next, the court may conduct a functional analysis, comparing the powers of the entity to be classified with those of entities excluded from bankruptcy relief. Finally, the court may examine the state statutes for characteristics common to excluded entities, those entities which conduct business of a public or

> quasi-public nature and are subject to extensive state regulation including a statutory scheme for liquidation or rehabilitation.

The first inquiry thus is whether AUG is treated as an insurance company under Indiana law. It most assuredly is not. The "Indiana Insurance Law" IC 27-1-2-1 (A-17) at IC 27-1-2-3(d) (A-17) defines "company" or "corporation" to mean an "insurance company." IC 27-1-2-3 then defines three different types of "companies" or "corporations" (i.e., three types of "insurance companies"), only one of which is relevant here:

> (e) The term "domestic company" or "domestic corporation" means an insurance company organized under the insurance laws of this state.

(A-17) (emphasis added). IC 27-1-6 then sets forth detailed statutory procedures and requirements for the formation of a "domestic corporation" "under the insurance laws" of Indiana.

The fact that AUG is not an insurance company under IC 27-1-2-3 is obvious: AUG was formed, not under the "insurance laws" of Indiana, but under Indiana's general corporate code now codified at IC 23-1. The general corporate code at IC 23-1-22-1(b) has provided:

> Corporations may be organized for pecuniary profit under this act for any lawful purpose or purposes, except . . . for the conduct of a[n] . . . insurance . . . business.

Indiana's Business Corporation Law and its Insurance Law are thus mutually exclusive -- an insurance company must be organized under the Insurance Law and cannot be organized under the Business Corporation Law.

Further evidence that AUG is not an insurance company under Indiana law is found in its name: "American Underwriters Group, Inc." The absence of the word "insurance" in its name is

significant because IC 27-1-6-3 (A-19) provides that the name of any insurance company organized under the Indiana Insurance Law "shall contain the word 'insurance'."

Other significant differences between corporations organized under IC 23-1, like AUG, and insurance companies organized under IC 27-1 abound. If this Court grants the writ, AUG will demonstrate such differences regarding procedures for incorporating; contents of articles of incorporation; requirements as to directors; restrictions on dividends and distributions; requirements as to corporate officers; amendments to articles of incorporation; mergers; voluntary dissolution; regulation of acquisition of controlling shareholder interests. The ability of insurance companies to establish subsidiaries, such

as the subsidiaries of AUG, is severely restricted by IC 27-1, while corporations organized under IC 23-1 are encumbered by no such restrictions.

An analysis of such differences in Family Health Services I led the Court to conclude that a health maintenance organization ("HMO") was not classified as an insurance company under Indiana law:

> Maxicare Midwest does not purport to be a "domestic insurance company" in its corporate name, its articles of incorporation or under the laws of the three states [Indiana, Illinois, Ohio].

104 B.R. at 273. The Court further noted that individual statutory schemes for the regulation of HMOs and insurance companies confirmed their separate treatment under the laws of Indiana. It thus referred to IC 27-8-7-17 which states that "Indiana insurance law does not apply to the operation of prepaid

health care delivery plans" except as specifically provided. It also noted differences in statutory definitions regarding insurers and HMOs. Id. at 274-275.

AUG is no more classified as an insurance company under Indiana law than is an HMO. Like an HMO, AUG is not an insurance company "in its corporate name, its articles of incorporation or under the laws of" Indiana. Like IC 27-8-7-17, IC 27-6-6-14 (A-37) states that "no law of this state relating to insurance shall apply to the exchange of indemnity contracts described herein [IC 27-6-6] unless they are specifically mentioned therein." Unlike a reciprocal association such as AIE, an attorney-in-fact such as AUG is not specifically mentioned in the definition of an "insurer" in the Indiana Insurance

Law at IC 27-1-2-3(x) (A-17) which states:

> The term "insurer" means a company, firm, partnership, association, order, society or system making any kind or kinds of insurance and shall include associations operating as Lloyds, reciprocal or inter-insurers, or individual underwriters.

(Emphasis added).

The next step under this test is to engage in a "functional analysis" to determine whether the entity at issue exercises the same powers as an insurance company. In Family Health Services I, the Court's analysis in this respect was the same as described in the above discussion of the independent classification test, i.e., the Court relied on Royal Drug for the proposition that the "central indispensable element of an insurance company is the underwriting or spreading of risk." Based on that analysis, the Court concluded that an HMO was not the

functional equivalent of an insurance company. As noted earlier, the same conclusion is compelled in this case because AUG did not underwrite any risks, and it therefore is not the functional equivalent of an insurance company.

The final step under this test is to examine the entity at issue for characteristics similar to those shared by the entities enumerated in Section 109(b). Characteristics most commonly examined are the extent of a state regulatory scheme, including liquidation proceedings, and whether the business is of a public or quasi-public nature. See Family Health Services I, 104 B.R. at 276; In re Southern Industrial Banking Corp., supra at 59 B.R. 982. The significance of this aspect of the test, however, is non-existent when, as in this case, it

has already been shown that the entity at issue is not treated as an insurance company under state law and is not the functional equivalent of an insurance company:

> Whether or not HMOs are regulated and liquidated under a state statutory scheme, however, is of little assistance in deciding whether an HMO is the substantial equivalent of an insurance company under state law. Maxicare Midwest is not transformed into an insurance company by providing for its liquidation under the supervision of the Illiois [sic] Director of Insurance, Indiana Commissioner of Insurance and the Ohio Superintendent of Insurance.
>
> Today's ruling is consistent with other decisions which have given little or no weight to statutory liquidation schemes in applying the state classification test. For example, in Cash Currency, the Seventh Circuit held that under the state classification test, a statutory scheme for an entity's liquidation has never been deemed sufficient to classify that entity as one excluded under section 109(b)(2). . . .
>
> Thus, the courts have rejected the argument that by providing for liquidation of an entity under the

> banking or insurance laws, the state thereby classifies the entity as one excluded under section 109(b)(2).

Family Health Services I at 104 B.R. 276 (citations omitted and emphasis added).

In arguing that AUG is an insurance company under Section 109(b), the Commissioner has asserted that AUG is not an HMO and whether an HMO is treated as an insurance company is not dispositive of this case. Citing two cases, he says there is a split of authority on that question. Both of those cases, however, cited and ultimately focused on the same fundamental insurance concept of the underwriting and spreading of a policyholder's risk as stated in Royal Drug. Both cases thus concluded that the providing of medical services as opposed to direct indemnification was merely a service in kind rather than cash, and there was no functional difference

between an HMO and an insurance company from the viewpoint of the subscribers or policyholders of the HMO. In re Beacon Health, Inc., 105 B.R. 178, 186-187 (Bankr. D. N.H. 1989); In re Portland Metro Health, Inc., 15 B.R. 102, 104-105 (Bankr. D. Or. 1981). Neither case considered Indiana law.

The Commissioner has also cited In re International Underwriters, Inc., 157 F. Supp. 367 (W.D. Mo. 1957), which applied the independent and state classification tests to an attorney-in-fact of a reciprocal and concluded that the attorney was an insurance company for purposes of the Bankruptcy Act. That case was decided before Royal Drug, but in reaching its conclusion, the Court in fact focused on the same fundamental insurance concept of the underwriting and spreading of a policyholder's risk

recognized in Royal Drug. It thus said:

> Second, petitioner asserts that the attorney in fact is not an insurer because it runs no risk of being required to pay a beneficiary or insured a larger sum of money than the amount paid in by that person. Concededly, risk is an essential factor of the insurance business, and in the absence of risk imposed upon an entity, regardless of the other like functions it performs, it is not an insurer.

Id. at 371 (emphasis added).

After noting that the reciprocal policy limited the liability of subscribers to the fee and premium stated in the policy, the Court based its conclusion on its construction of a Missouri statute which provided:

> If at any time the amounts [of reserves] on hand are less than the requirements of sections 375.840 and 375.850, the subscribers or their attorney [original emphasis] for them shall make up the deficiency.

The Court construed the statute to mean that a deficiency in reserves must be made up by the attorney and that risk was

thus assumed by the attorney under the Missouri law. Id. While the power of attorney in this case similarly limits liability and Indiana has a statute with similar language, risk is clearly not assumed by the attorney under the Indiana law.

IC 27-6-6-6 (A-28) concerns maintenance of reserves and provides in part:

> If at anytime the assets so held in cash or such securities shall be less than required above . . . the subscribers or their attorney for them shall make up the deficiency . . . .

In Wysong v. Automobile Underwriters, Inc., 204 Ind. 493, 184 N.E. 783, 787 (1933), the Indiana Supreme Court construed that provision to mean:

> It is up to the attorney and subscribers whether or not they desire to make up the deficiency, if there is one, and continue in business, or whether they desire to refuse and go out of business.

> The word "shall" in the sentence contained in section 6 (Burns' 1926, § 9313), wherein it is said "shall make up the deficiency," should be construed to mean "may" in order to give effect to the evident intent of the Legislature in enacting the Reciprocal Act of Insurance.

(Emphasis added). According to Wysong, AUG clearly has the option not to continue business as attorney-in-fact for AIE as has happened in this case, and in such circumstances, AUG cannot be required to make up any deficiency. AUG thus does not assume any risk and is not an insurer under Indiana law.

Although International Underwriters cites Wysong in the course of its opinion, it does not cite Wysong as support for its construction of the Missouri statute which is obviously contrary to the Wysong construction of the Indiana statute above. International Underwriters is also contrary to

Underwriters' Exchange, supra at 185 N.E. 506-507, where the Indiana Supreme Court held that an attorney-in-fact is not an insurer and cannot be compelled to pay any loss in the insurance operation. It is further contrary to Ind. Dep't of Revenue, supra at 429 N.E.2d 311, where the Indiana Court of Appeals recognized:

> All assets of [AIE] are subject to the liability of the insurance operation, but none of the assets of [AUG] are available to those claimants.

The only other case cited by the Commissioner with regard to this issue involved a reciprocal insurer and not an attorney-in-fact nor Indiana law. In re Manufacturing Lumbermen's Underwriters, 18 F. Supp. 114 (W.D. Mo. 1936).

After marching through all the steps in this test, there is only one conclusion: AUG is not treated as an insurance company under Indiana law.

The Alternate Relief Test

This test was first articulated in In re Republic Trust & Savings Co., supra at 59 B.R. 614. The key question of this test is whether a federal bankruptcy proceeding is a satisfactory alternative to a state insolvency proceeding. Family Health Services I, 104 B.R. at 277.

The Family Health Services cases focused on three critical distinctions between the relief available under the Bankruptcy Code and state insurance insolvency statutes, one of those being IC 27-9: (1) the protections afforded unsecured creditors under the Bankruptcy Code which are not afforded under the state statute; (2) the preferential treatment given to loss claimants under the state statutes which "is anathema to the basic tenet of federal bankruptcy law"; and (3) the clear policy of the

Bankruptcy Code for a nationwide and uniform system of insolvency laws. Id. at 104 B.R. 277-278, 287-288. Based on those distinctions, the Court concluded that under this test, the Bankruptcy Code provided satisfactory relief and that HMOs were not, therefore, insurance companies under Section 109(b). Those distinctions are equally true in this case.

Summary Of The Tests

As the foregoing analysis demonstrates, under each of the three tests it is clear that AUG is not an insurance company for purposes of Section 109(b). Therefore, if Indiana's insurance insolvency statute is construed as it was in this case to include attorneys-in-fact such as AUG, there is a collision between the Bankruptcy Code and IC 27-9. Under the authorities cited

above, it is the Bankruptcy Code rather than the Indiana statute which survives that collision.

The pre-emption issue does not arise only when bankruptcy proceedings are initiated.

The Commissioner has previously mischaracterized AUG's argument by asserting that AUG is contending the Bankruptcy Code "generally pre-empts" IC 27-9. AUG is not presenting any such contention. AUG contends that the Bankruptcy Code pre-empts IC 27-9 specifically as to attorneys-in-fact who act as agents and not as insurers, such as AUG, because they are not excluded from the Bankruptcy Code and they therefore cannot be subjected to an insolvency statute such as IC 27-9 which is tantamount to bankruptcy as previously demonstrated.

The Commissioner has extended his

mischaracterization of AUG's argument by asserting that AUG's argument taken to its logical conclusion would require pre-emption of other state statutes involving receiverships and assignments for the benefit of creditors. In that regard, he has claimed that even if AUG is not an insurance company excluded from the Bankruptcy Code, the application of IC 27-9 to AUG would not be pre-empted unless and until a bankruptcy proceeding is initiated.

The Commissioner's argument is confusing and misleading. If AUG is not an insurance company, there obviously is no basis whatsoever for the application of IC 27-9 to AUG. If IC 27-9 is applied, it establishes an exclusive and comprehensive scheme precluding the availability of any alternative "for the purpose of liquidating, rehabilitating,

reorganizing or conserving" an insurer as AUG has argued in demonstrating that IC 27-9 is tantamount to bankruptcy. IC 27-9 does not compliment or augment the Bankruptcy Code to any extent, but rather it entirely displaces the Bankruptcy Code as to those entities subject to its provisions. AUG is not contending that the Bankruptcy Code pre-empts other state statutes involving receiverships or assignments for the benefit of creditors which are not tantamount to bankruptcy.

The Commissioner has cited Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518 (1933), which he has also mistakenly characterized as holding that a state statute providing for an assignment for the benefit of creditors was not suspended or pre-empted due to the fact that the proceedings under the statute could be terminated by the timely filing

of a bankruptcy petition. The decision in Pobreslo was in fact based upon the analysis of the state statute itself which was found not to be tantamount to bankruptcy.

This Court in Pobreslo compared the state statute to the one involved in International Shoe Co. v. Pinkus, supra, which was held to be tantamount to bankruptcy and found significant differences. The proceedings in Pinkus were under a state insolvency law and not under the law governing assignments for the benefit of creditors. The statute in Pobreslo regulating the administration of trusts created by assignments for the benefit of creditors applied whether the assignor was solvent or insolvent. It did not prevent creditors from bringing action against the debtor. In harmony with the Bankruptcy Act, it served to

protect creditors against each other and to assure equality of distribution unaffected by any requirement or condition. 287 U.S. at 525-526. Pobreslo thus reaffirms Pinkus and is consistent with AUG's argument.

Other cases cited by the Commissioner regarding his argument likewise acknowledge the decisions of this Court cited by AUG. According to those decisions, the pre-emption of a state insolvency statute occurs whenever the state law conflicts with the national law of bankruptcy. It is the conflict of such laws which gives rise to the pre-emption of the state law. The issue is not dependent upon the initiation of a bankruptcy proceeding to be ripe for consideration. There was in fact no bankruptcy proceeding in Pinkus.

II.

The decision below that an attorney-in-fact such as AUG is an insurer subject to an insurance insolvency statute such as IC 27-9 raises important questions which should be settled by this Court.

AUG was an agent and not an insurer. The logic of the opinion below means that any agent licensed by the Indiana Department of Insurance is subject to the exclusive insolvency proceedings of IC 27-9 as an insurer simply because of the fact that the agent has a license or certificate of authority from the Department to do insurance business, "albeit in the name of" a principal. All agents licensed to do insurance business are regulated by their licensing authority. Congress, however, has chosen to exclude insurance companies but not insurance agents from the Bankruptcy Code. The logic of the opinion below

threatens to undermine the boundary drawn by the Constitution and prior principles established by this Court regarding the exclusive power and jurisdiction of Congress on the subject of bankruptcy.

This Court has not directly addressed the different tests as they have evolved today to determine who may be excluded from the scope of the Bankruptcy Code and thus subjected to the plenary power of the states under a statute such as IC 27-9. Bankruptcy today is becoming more and more a part of our society. This Court in the past has provided uniformity and guidance to lower courts on the subject of bankruptcy, and it is now time for this Court to do so again.

CONCLUSION

For all of the foregoing reasons, AUG respectfully requests that its petition for a writ of certiorari be granted.

Respectfully submitted,

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